



ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson
Director*

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

**Friday September 9, 2011
8:30 a.m., Arizona Time**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. David Byers, Chair of the ASRS Board, called the meeting to order at 8:38 a.m., Arizona Time.

Due to technical limitations with the sound equipment, this meeting was NOT teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. David Byers, Chair
Mr. Tom Manos, Vice-chair
Mr. Tom Connelly
Mr. Chris Harris
Professor Dennis Hoffman
Mr. Kevin McCarthy
Mr. Michael Townsend
Mr. Larry Trachtenberg

Absent: Mr. Steve Zeman

A quorum was present for the purpose of conducting business.

Mr. Tom Connelly arrived at 8:39 a.m.

2. Approval of the Minutes of the July 15, 2011 Public Meeting of the ASRS Board

Motion: Mr. Chris Harris moved to approve the minutes of the July 15, 2011 Public Meeting of the ASRS Board. Prof. Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Presentation, Discussion and Appropriate Action Regarding a Comparison of Statewide Public Pension Plans

Mr. Paul Matson, Director, introduced the topic. Mr. Patrick Klein, Assistant Director, External Affairs, provided a comprehensive presentation comparing the four public statewide defined benefit (DB) plans (ASRS, Public Safety Personnel Retirement System (PSPRS), Corrections Officer Retirement Plan (CORP), and Elected Officials' Retirement Plan (EORP) and the two city DB plans (Phoenix and Tucson)). Mr. Klein's presentation highlighted the demographic, financial, and operational statistics and provisions of the plans.

Mr. Klein noted the ASRS is more than five times larger than the other plans. Discussion occurred regarding the differences in contribution rates among the plans, and the different methods the plans use to fund their alternate contribution rates. Trustees asked if there are still issues when employees from other plans change systems. Mr. Klein said the most common problems arise when police and fire employees change jobs. It is often difficult to determine whether they are members of the PSPRS or the ASRS.

4. Presentation, Discussion and Appropriate Action Regarding the Organizational and Financial Status and Trajectory of the ASRS and its Relation to the ASRS Strategic Plan, Resource Allocation, and Strategic Direction

Mr. Matson provided his current assessment of the various organizational and financial aspects for each of the ASRS' major programs: the defined benefit plan, long term disability program, health insurance program and premium benefit supplement. He summarized his outlook for each area, some of the different tools used by staff to measure these aspects, current areas of strategic focus, and resource allocation. Each major program included evaluations in the areas of governance, fiscal integrity, core member services, administrative effectiveness, and the external environment. Discussion occurred regarding some possible different approaches to managing the funded status of the defined benefit plan as well as various governance issues.

5. Presentation, Discussion and Appropriate Action Regarding Preliminary 2012 Pension Plan, Health Insurance, System, and LTD Contribution Rates and Funded Statuses

Mr. Matson provided a presentation on the subject. At the end of fiscal year 2010, and again in 2011, the ASRS Actuary calculated projections of the funded status and contribution rates for the Pension Plan, Health Insurance Supplement, System, and LTD plans administered by the ASRS. Mr. Matson presented the comparison charts of these two sets of projections.

Mr. Matson pointed out that among the changes is a lower expected peak contribution rate for the Pension Plan, 11.48% in the 2010 projection and 10.80% in the 2011 projection. In addition to a lower peak contribution rate in the 2011 projections, this lower peak occurs five years earlier than formerly projected, in fiscal year 2014, and then begins to decrease. He said the actuarial funded status for the Plan is now projected to be over 80% in fiscal year 2021, 11 years sooner than projected in 2010.

Mr. Matson noted the ASRS Health Insurance Supplement program is well funded in comparison to all other states. In addition to declining contribution rates, the program is projected to achieve and maintain an actuarial funded status in excess of 80% in fiscal year 2019, 20 years sooner than the previous year's projections showed. Discussion ensued regarding the optional program. Mr. Charlie Chittenden, Actuary, Buck Consultants, also answered various questions Trustees had.

Mr. Matson said the Long Term Disability program also has experienced improvements in funded status and contribution rates from the 2010 projection to the 2011 projection. He explained an 80% actuarial funded status is expected to be achieved in fiscal year 2024 whereas it had not been projected to reach that level of funding until after fiscal year 2039 in the 2010 projection.

*The Board recessed at 10:48 a.m. for a brief break.
The Board reconvened at 11:00 a.m.*

6. Presentation, Discussion and Appropriate Action Regarding Employer Withdrawal Liability

Mr. Matson introduced the topic. Mr. Klein explained the request to discuss employer withdrawal liability came from the External Affairs Committee. Mr. Klein reviewed proposed circumstances under which an ASRS employer may withdraw from ASRS membership and discussed the methodology associated with determining the liability created by the withdrawal.

Mr. Klein said currently there is no statutory mechanism for an ASRS employer to withdraw their participation. He noted, likewise, there is no statutory requirement that once an employer becomes a member that membership is irrevocable. There is some Arizona case law, however, to support the irrevocability theory.

Mr. Klein pointed out, over the recent past few years, the ASRS has experienced legislative action to privatize two political subdivisions; the State Compensation Fund and the Arizona Department of Commerce. He said the ASRS also had several inquiries from employers about the possibility of withdrawing their membership.

Mr. Klein presented a methodology provided by Buck Consultants regarding employer withdrawals. Trustees discussed potential issues relating to possible employer withdrawals. One concern is how to define what constitutes an employer, and if an agency such as the Department of Commerce closes, is the state or the agency the employer. Ms. Jothi Beljan, Assistant Attorney General, noted statute clearly identifies entities, legally. Mr. Klein said the ASRS administratively and operationally views entities as separate employers, though. Trustees asked staff to work on defining what constitutes an employer.

7. Presentation, Discussion and Appropriate Action Regarding Permanent Benefit Increase Methodology and its Implications

Mr. Matson reviewed the Permanent Benefit Increase (PBI) methodology. Statute calls for amounts to be transferred to reserves for PBIs in any year when investment returns on the actuarial value of retirement (401(a)) assets in the plan exceed 8%. PBI reserves are used to provide increases to members who have been retired for at least one year, provided the amount of the PBI is, in aggregate, at least 1%. Mr. Matson said the last PBI was in fiscal year 2005 with the next PBI projected to be in approximately fiscal year 2019.

Mr. Matson noted many other systems previously had only projected the next one to two years, but the ASRS has been looking at projections over the next 30 years to mitigate risks. He explained concerns regarding changing the methodology involving inequitable distributions; payments unrelated to financial health, contribution rates; inflation, variability of potential costs; and a complex current methodology.

Mr. Matson pointed out a mitigating factor with respect to ensuring funded stability is the ASRS Board currently has the authority to modify the period actuarial assets are smoothed which would result in:

- More level payouts for retired members
- Lower liabilities

Trustees discussed additional possible modifications including a legislative provision that would exclude transfers to PBI reserves whenever the Plan's funded status was lower than a percentage to be determined or when member contribution rates are higher than a percentage to be determined. This provision would eliminate the requirement to transfer assets when the Plan is not well enough funded to do so. Trustees also discussed a methodology that uses a

percentage of assets rather than liabilities.

8. Presentation, Discussion and Appropriate Action Regarding the ASRS Health Insurance Plan and Impacts of Federal Legislation and Discussion of Multi-Vendor Models, a Self-Funding Model, and a Status Update on the Current Contract

Mr. Klein introduced Ms. Karen Battilana, Benefit Services Director, and Mr. Paul Shannon, Assistant Director, Finance and Budget, Arizona Department of Administration (ADOA). Ms. Battilana introduced Mr. Michael Meisner, Actuary, ADOA. Mr. Klein reviewed the ASRS retiree health insurance program's 2012 UnitedHealthcare renewal. Discussion ensued regarding increased premiums, among other issues. Ms. JoAnn Cipiti, Benefits Consultant, Buck Consultants, fielded Trustees' questions.

Mr. Klein discussed the impacts of federal legislation, explaining much of it does not affect the ASRS since we are not considered to be an employer, rather a retiree health plan. He said the ASRS does align itself with many of the mandates, to ensure we are compliant.

The Board recessed at 12:44 p.m. for a brief break.

The Board reconvened at 1:03 p.m.

Ms. Battilana presented an overview of ADOA's self-funding and multi-vendor models.

Mr. Tom Connelly departed the meeting at 2:00 p.m.

Trustees discussed the possibility of the ASRS retiree health insurance program offering a self-funding and/or multiple vendor model. Mr. Klein suggested going out to bid for health insurance for 2013. Trustees agreed. Mr. Matson indicated that the RFP might also include a self-insurance component.

9. Presentation, Discussion and Appropriate Action Regarding ASRS Investment Statutes and Possible Modernization

Mr. Gary Dokes, Chief Investment Officer, addressed the Board regarding the current structure of ASRS investment statutes and a potential ASRS 2012 legislative item to revise and modernize the statutes.

Mr. McCarthy departed the meeting at 2:03 p.m.

Mr. Dokes noted, during the summer the External Affairs Division (EAD), Investment Management Division (IMD) and the Director's Office reviewed the current ASRS investment statutes to determine whether revisions should be made. The EAD presented the results to the External Affairs Committee (EAC) on September 2, 2011, and the EAC recommended the Board review the current statutes and the potential revisions. The revisions presented to the EAC clarify various aspects regarding the investment process and make other conforming changes.

Mr. Dokes pointed out that some provisions in the investment statutes are outdated and no longer apply, and some are ambiguous, driving the need for changes.

Trustees indicated the Investment Committee also wants to modernize the statutes. Mr. Tim McCusker, Partner, Director of Traditional Research, NEPC, supported this decision. Discussion ensued among Trustees and Mr. David Byers, Chair, summarized the conversation,

stating everyone seemed to agree that the ASRS should continue to move forward to revise the statutes.

10. Presentation, Discussion and Appropriate Action Regarding the ASRS Biennial Risk Assessment for Fiscal Years 2012 and 2013

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, introduced the topic, explaining the report outlines the ASRS' known business risks and threats; assesses the ASRS risk tolerance, controls, and magnitude; and explains strategies that have been or will be implemented to reduce the threat. Ms. Lisa King, Policy Analyst, Strategic Planning and Analysis, presented a summary of the report, outlining some of the risks and control strategies identified for FY 2012 and 2013. Mr. Guarino said the control strategies were discussed with the Operations Committee.

Motion: Mr. Chris Harris moved to approve the Biennial Risk Assessment for FY 2012 and 2013. Mr. Tom Manos seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

11. Presentation, Discussion and Appropriate Action Regarding the ASRS Internal Audit Division Biennial Audit Plan for Fiscal Years Ending 2012 and 2013

Due to time constraints and trustees' schedules, this topic was postponed to a future meeting.

12. Presentation, Discussion and Appropriate Action Regarding the Director's Report as well as Current Events

Mr. Matson presented the Director's Report, noting after the Board had approved the 2013 Budget, the ASRS was able to lower the budget requirement by \$842,000, and that this would result in a lower budget request submitted to the Office of Strategic Planning and Budgeting and the Joint Legislative Budget Committee.

Mr. Matson said a lawsuit has been filed by the City of Scottsdale. The City of Scottsdale owes the ASRS funds and has paid the ASRS a portion of the amount owed. The suit names the ASRS as defendant and seeks a declaratory judgment regarding the early retirement program invoice amount.

Mr. Matson updated the Employers portion of the Director's Report to reflect only \$123,000 is owed by employers to the ASRS.

13. Board Requests for Agenda Items

No requests were made.

14. Call to the Public

No requests to speak were made.

Mr. Dave Byers noted that Mr. Paul Matson was selected Leader of the Year in Public Policy by the Arizona Capitol Times. Mr. Matson is the recipient of the award for the government category.

15. The next regular ASRS Board meeting is scheduled for Friday, October 21, 2011, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

16. Adjournment of the ASRS Board

Mr. Byers adjourned the Board meeting at 2:34 p.m.

ARIZONA STATE RETIREMENT SYSTEM

Lisa Maddox
Board Secretary

Date

Paul Matson
Director

Date